FILE COPY

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1927

No. 575/17

GILBERT C. GREENWAY, JR.,

Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT, AND BRIEF IN SUPPORT OF PETITION.

Constitutionality of Section 202 (a) (2), Revenue Act, 1921 (42 Stat. 227). The question presented by this petition is whether the provision of the above Act, which required a donee to use the cost of the property to the donor as a basis for computing profit for income-tax purposes, was unconstitutional in so far as it taxed to the donee, as income, increment in the value of a gift which accrued prior to its acquisition by the donee.

ROGER S. BALDWIN,
Counsel for Petitioner,
120 Broadway,
New York, N. Y.

LAWYERS PRESS, INC., 165 WILLIAM STREET, NEW YORK CITY, N. Y.

INDEX

PAGE

Petition 1

Brief 7

I. An entirely new principle in Income Tax Law of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift is involved 8

II. It was error to hold that the increase in value which accrued during the time the stock was held by the petitioner's donor was income taxable to the petitioner 9

III. It was error to hold that Congress could enact Section 202 (a) (2) of the Revenue Act of 1921 in the exercise of its general power to levy taxes 11

Conclusion 13

Cases Cited.

Edwards v. Cuba R. R. Co., 268 U. S. 628 10

Eisner v. Macomber, 252 U. S. 189 9

Goodrich v. Edwards, 255 U. S. 527 9

Gray v. Darlington, 82 U. S. 63 9

Lynch v. Turrish, 247 U. S. 221 9

Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509 9

Towne v. Eisner, 242 Fed. 704 10

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,
Respondent.

PETITION OF DEFENDANT IN ERROR FOR A WRIT OF CERTIORARI TO REVIEW THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Supreme Court of the United States:

The petition of Gilbert C. Greenway, Jr., the defendant in error below, respectfully shows:

I. That this is an action at law brought in the United States District Court for the Southern District of New York to recover $4,441.61, income tax, paid under protest by the petitioner to the respondent for the calendar year 1922.

II. Said action for such recovery was brought on the ground that Section 202 (a) (2) of the Revenue Act of

1921 (42 Stat. 227), under which such tax was imposed, is in violation of Subdivision 4, Section 9 of Article I of the Constitution of the United States and of Article XVI of the amendments thereto, and is also in conflict with other provisions of the same Revenue Act.

III. The respondent moved in the District Court to dismiss the complaint on the ground that it failed to state facts sufficient to constitute a cause of action. Said motion was denied, the learned District Court holding that Section 202 (a) (2) of the Revenue Act of 1921 in so far as it attempts to tax as income to the donee, upon its subsequent sale by the latter, the increase in value of the corpus of a gift over its original cost while held by the donor, was unconstitutional.

IV. On appeal to the Circuit Court of Appeals for the Second Circuit, the judgment of the District Court was reversed by a divided court, Judges Manton and Hand voting for a reversal and Judge Swan voting for an affirmance of the judgment of the District Court. The order on mandate reversing the judgment of the District Court was entered on the 13th day of July, 1927.

V. Ninety (90) days have not elapsed since the entry of the said order in accordance with the decision of said Circuit Court of Appeals.

VI. The petitioner respectfully moves this Court for a Writ of Certiorari to review the said decision of the Circuit Court of Appeals for the Second Circuit.

VII. The case of the petitioner is based on the following facts, concerning which there is no dispute:

During 1921 and 1922, plaintiff's brother, John C. Greenway, owned 10,000 shares of Ahumada Lead Com-

pany stock for which he had paid $10,000. On March 29, 1921, he made a gift to the petitioner of 5,000 shares of such stock, the market value of which at that time was $13,750. On March 1, 1922, he gave the remaining 5,000 shares to the petitioner, the market value of which at that time was $16,250. On August 1, 1922, petitioner sold the 10,000 shares for $52,500 and solely in obedience to the provisions of Section 202 (a) (2) of the Revenue Act of 1921, which provides:

> "(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that * * *
>
> (2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor, or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

petitioner reported in his Income Tax return for 1922, a profit of $42,500 on the sale of the stock, which amount was the difference between the cost of the stock to the petitioner's donor and the amount for which the petitioner sold the same.

Petitioner paid the tax thereon protesting, however, that so much of said tax, to wit: $4,441.61, as was assessed on the increase in value of the stock during the time it was owned and held by the petitioner's donor, was assessed unlawfully and in violation of the provisions of the Constitution of the United States.

VIII. Thereafter and on March 27, 1924, petitioner filed a claim for refund of said $4,441.61 and after the expiration of six months thereafter this action was commenced in the District Court in which the question of the constitutionality of the provisions of Section 202 (a) (2), above set forth, was raised.

IX. For the reasons set forth in the annexed brief, your petitioner believes that the decision of the Circuit Court of Appeals was erroneous and contrary to law, and that this honorable Court should require the case to be certified to it for review and determination in conformity with the Acts of Congress in such case made and provided.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding the said Court to certify and transmit to this Court, on a day to be therein designated, a full and complete transcript of the record and all proceedings of the said Circuit Court of Appeals in the said case therein, entitled "Frank K. Bowers, Etc., Plaintiff in Error, v. Gilbert C. Greenway, Jr., Defendant in Error, (No. 294)," to the end that the case may be reviewed and determined in this Court, as provided by Section 240 of the Act of Congress designated as the Judicial Code, and that the said judg-

ment of the said Circuit Court of Appeals in this case and every part thereof may be reviewed by this honorable Court and that the judgment of the District Court be confirmed and that such other and further relief be granted as to the Court shall seem just and equitable and in conformity with the law.

GILBERT C. GREENWAY, JR.,
Petitioner.

ROGER S. BALDWIN,
Counsel.

STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.:

GILBERT C. GREENWAY, JR., being duly sworn, says that he is the petitioner named in the foregoing petition, and that he has read the same, and that the allegations thereof are true, as he verily believes.

GILBERT C. GREENWAY, JR.

Subscribed and sworn to before me }
this 30th day of September 1927. }

M. PHILIP,
Notary Public, Kings County,
Kings Co. Clks. No. 287, Reg. No. 9089,
N. Y. Co. Clks No. 133, Reg No. 9133,
Commission expires March 30, 1929.

IN THE

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

BRIEF IN SUPPORT OF PETITION.

Statement.

This action was commenced by the petitioner in the United States District Court, Southern District of New York, to recover $4,441.61, income tax, paid in the year 1923. The opinion of the District Court is reported in 15 Fed. (2) 890. Judgment was entered for the petitioner on September 10, 1926 (R. 23-25). The Circuit Court of Appeals reversed the judgment of the District Court. The opinions of the Circuit Court of Appeals are reported in 20 Fed. (2) 561. The order reversing the judgment of the District Court was filed July 13, 1927 (R. 42). In the proceeding below the petitioner claimed that the increment in the value of certain stock, to wit, $20,000, which accrued prior to his ownership was not

income, (R. 7), and, hence, the statute which taxed it as such was unconstitutional (R. 8). The petitioner relies upon Section 240 of the Judicial Code as authority for the jurisdiction of this Court. All of the material facts are set forth in Paragraph VII of the Petition and on Pages 4-8 of the Record. The errors to be urged are specifically set forth in Points 2 and 3 of this brief.

1. This case involves an entirely new principle in income tax law and is of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift.

Section 202 (a) (2) of the Revenue Act of 1921, quoted in the foregoing petition, requires every donee of property, received after December 31, 1920, to use as the basis for determining the gain or loss on a subsequent sale of the property the cost to the donor or the last preceding owner by whom it was not acquired by gift.

Similar provisions are contained in Section 204 (a) (2) of the Revenue Act of 1924 and in Section 204 (a) (2) of the Revenue Act of 1926 so that the question involved in this case is of very present interest.

The Section above referred to is in direct conflict with Section 213 (b) (3) of the same Act (Revenue Act of 1921) which provides that gross income does not include the value of property acquired by gift.

So far as counsel for petitioner has been able to discover the question involved in this case has never been presented to this Court and has never been determined by any Court except in this case, and the kindred case of Elizabeth C. Taft against Frank K. Bowers, Collector, which was heard and decided by the District Court and Circuit Court of Appeals at the same time as the present case.

The Circuit Court of Appeals by a divided Court sustained Section 202 (a) (2) as a valid legislative enactment. Judge Swan dissented and agreed with District Judge Knox that the statute was unconstitutional. Each of the three Judges of the Circuit Court of Appeals wrote a separate opinion, and Judge Knox also rendered an opinion in the District Court. The opinions which are printed in the Record which accompanies this application show the diversity of reasoning upon which the four Judges of the Courts below based their conclusions.

Section 202 (a) (2) introduced an innovation in income tax legislation, the validity of which it is respectfully submitted should be finally determined by this Court.

2. The Circuit Court of Appeals erred in holding that the increase of $20,000 in the value of the stock which accrued during the time it was held by the petitioner's donor was income taxable to the petitioner.

This Court has consistently held that the increase in value of capital does not constitute income.

Gray v. *Darlington*, 82 U. S. 63;
Lynch v. *Turrish*, 247 U. S. 221.

This Court has defined income to be

> "The gain derived from capital, from labor, or from both combined, provided it is understood to include profit gained through a sale or conversion of capital assets."
>
> *Eisner* v. *Macomber*, 252 U. S. 189, 207;
> *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 518;
> *Goodrich* v. *Edwards*, 255 U. S. 527, 535.

Amplifying the above definition, Mr. Justice Pitney said further in *Eisner* v. *Macomber, supra,* at page 207 that income is

> "*not* a gain *accruing* to capital, nor a *growth* or *increment* of value *in* the investment."

In *Edwards* v. *Cuba R. R. Co.,* 268 U. S. 628, this Court held that the value of physical properties and money given by the Cuban Government to the railroad company by way of subsidy was not income within the meaning of the Sixteenth Amendment.

The fact that Congress expressly declared the increase in value during the ownership of the donor to be income of the donee upon the subsequent sale by the latter does not make such increase income if in fact it is not such.

In *Eisner* v. *Macomber, supra,* this Court quoted with approval the following language from the opinion of Judge A. N. Hand in *Towne* v. *Eisner,* 242 Fed. at page 704:

> "It is manifest that the stock dividend in question cannot be reached by the Income Tax Act, and could not, even though Congress expressly declared it to be taxable as income, unless it is in fact income."

3. The Circuit Court of Appeals erred in holding that Congress in the exercise of its general power to levy taxes could enact Section 202 (a) (2) of the Revenue Act of 1921.

Judge Manton in his opinion said—

> "But the question is whether the method adopted by Congress for measuring income is, in

> the case of the donee, a reasonable one in the aid of purposes of Federal income taxation. * * *
>
> "The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred is essential to the entire taxing scheme. * * *
>
> "The statute may, indeed, be said to be an execution of the main design of the income-tax Act."

Judge Hand in his opinion said—

> "That the statute is reasonably ancillary to a valid constitutional provision seems to me as plain as in *Rice* v. *Eisner*, 16 Fed. (2) 353."

Again, Judges Manton and Hand attempt to support their conclusions by pointing out that the same result might have been obtained by the levy of an excise tax. In this connection Judge Manton stated—

> "No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift and the tax could have been measured by the difference between the price paid for it and its value when he transferred it. Nor could it be criticised if the donee was left to pay the balance of the tax based upon the difference between the value on the date of acquisition and the value on the date of sale."

Judge Hand stated:

> "Therefore there is a subject-matter which Congress may tax without apportionment and part of which, after *Eisner* v. *Macomber*, it could not tax in any other way, except, perhaps, as an excise."

This reasoning ignores completely the fundamental principle that property obtained by gift is capital, not

income, in the hands of the donee, and that under the Sixteenth Amendment Congress can only tax without apportionment among the states that which is in fact income. The majority opinions also fail to take into account the distinction made in the Constitution between direct taxes and excise taxes. It does not follow that because Congress can impose an excise tax without apportionment upon the exercise of certain rights and privileges it can lay a direct tax upon the subject matter involved in the exercise of such rights and privileges without apportionment.

The principles which control in this case are stated clearly and correctly by Judge Swan in his dissenting opinion, as follows:

> "It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. *Eisner* v. *Macomber*, 252 U. S. 189. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. *Edwards* v. *Cuba Railroad*, 268 U. S. 628; *United States* v. *Oregon-Washington & Co.*, 251 F. 211 (C. C. A. 2). * * *
>
> "The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the taxpayer's income must be a gain derived from *his* capital, or *his* labor, or from both combined."

Conclusion.

WHEREFORE, the petitioner respectfully prays that this Court take jurisdiction of this question because:

1. This case involves an entirely new principle of income tax law and is of vital importance to every taxpayer who has sold or may hereafter sell property acquired by gift.

2. The Circuit Court of Appeals erred in holding that the increase of $20,000 in the value of the stock which accrued during the time it was held by the petitioner's donor was income taxable to the petitioner.

3. The Circuit Court of Appeals erred in holding that Congress in the exercise of its general power to levy taxes could enact Section 202 (a) (2) of the Revenue Act of 1921.

ROGER S. BALDWIN,
Counsel for Petitioner,
120 Broadway,
New York, N. Y.

Supreme Court of the United States

October Term, 1927

GILBERT C. GREENWAY, JR.,
Petitioner,

v.

FRANK K. BOWERS, Collector of United States Internal Revenue for the Second District of the State of New York,
Respondent.

No.

Sir:

PLEASE TAKE NOTICE that I have filed in the Supreme Court of the United States a petition for a writ of certiorari in this cause, a copy of the record and a brief, of which copies are hereto annexed and herewith served upon you. Pursuant to Subdivision (4) of Rule 35 of the Supreme Court, the said petition, record and brief will be submitted to the Court on the first motion day following the expiration of twenty days after service of this notice upon you.

Dated, New York, October 4, 1927.

ROGER S. BALDWIN,
Attorney for Petitioner,
120 Broadway,
New York, N. Y.

To:
Hon. WILLIAM D. MITCHELL,
Solicitor General,
Washington, D. C.

Due service of the foregoing notice and the annexed petition, record and brief are hereby acknowledged.

October , 1927.

Attorney for Respondent.